To countries with a small influx of immigrants, such as Great Britain and Germany, this theory may appear altogether inapplicable. The question, however, is whether they have within their own boundaries precapitalistic areas of low and stable standards of living and of wages determined independently of capitalistic industry. To some extent this is still true, tho it must be admitted that such regions are rapidly losing their old time character. The precapitalistic areas of Great Britain and Germany, and indeed those of Europe generally, are becoming merged into the modern industrial system. Perhaps soon they will be too inconsiderable to be regarded as sources of a marginal supply of labor. Then my theory of the supply price of labor will be without support in fact. I concede prophetic truth to Professor Taussig's judgment that the outcome of my reasoning about the supply of labor and of capital is that of an "impassive unregulated impact" between them, with no "normal" return for either wages or the profit of capital.

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INTERNATIONAL FREIGHTS AND PRICES

In this Journal for May, 1917 there is an article by Professor Taussig on international trade under depreciated paper, which has interested me very much, not only because of the theoretical importance of the problem treated, but with a view also to its obvious bearings on the practical questions of the present time

Still I venture to think that the concrete example chosen by Professor Taussig — America *versus* England — is too complex to be handled as it were in one single grasp. I propose therefore to approach the solution of the problem by some preparatory steps of a somewhat simpler character. It will be seen that on several points my conclusions are in agree-

ment with those drawn by Professor Taussig, altho based on a slightly modified range of argument; on some points, however, the agreement will be less complete.

I propose to assume at first two countries, both of them having free trade, and divided only by a land boundary. If these countries were both living under a specie régime there could not possibly exist different prices of the same commodity on both sides of the frontier; and if we suppose, which of course is not exactly true, that the level of prices in the interior of each country is materially the same as in the boundary districts, there could be no difference of prices at all between them.

Now the influence of borrowing, which is the main subject discussed by Professor Taussig, would show itself, for the time being, in an increasing power of purchase in the borrowing, a diminishing power of purchase in the lending country; and the result would be a greater amount of merchandise passing from the latter country to the former, a smaller amount from the former to the latter; in other words, increasing imports and diminishing exports on the side of the borrowing country. The stimulus to these altered conditions of trade is not to be found in a difference of prices in the two countries, which would be theoretically impossible and practically confined between very narrow limits; the increased *demand* for commodities in one country, the diminished demand in the other, would in the main be sufficient to call forth the changes alluded to.

At the same time, however, the larger circulation of merchandise in the borrowing country would require — other things being equal — a somewhat greater amount of money to put it in motion; very likely, therefore, a certain quantity of gold would pass automatically from the lending to the borrowing country. If we suppose the borrowing operations to be continued for some years on about the same scale, this transmission of gold would appear at the very beginning of the period and then stop; its effect would not be a rise of prices in the borrowing country, but only their continuance at their ordinary level; and at the same time a somewhat

smaller amount of gold in the lending country would be all that was required there in order to buy and sell the lessened amount of merchandise at the ordinary prices. I cannot see that it would make any difference in this respect, if the increased power of purchase in the borrowing country is directed towards home products rather than imported commodities; this of course would diminish the imports, but if the value of imports surpasses the value of exports by precisely the amount borrowed during the same time, there would be no occasion for sending or receiving gold.

If, on the other hand, the borrowing country had a depreciated paper currency, the result no doubt would be different. As there is no opportunity for sending gold from the lending country, prices there will rise, and in the borrowing country, if with Professor Taussig we suppose the quantity of paper unaltered, prices, *reckoned in paper*, will fall. The seeming paradox of merchandise going in increased quantities from a country where prices are rising, to a country where they are falling, will disappear at once if we consider that the prices *reckoned in gold* will necessarily rise in the borrowing country too — practically indeed somewhat more than in the lending country — so that the specie premium will go down from both these causes.

This is a point of a very great interest. In both countries put together there is still, physically, the same amount of money, gold and paper. But *virtually* the quantity of gold has risen because the paper now represents more gold; therefore the gold prices will rise and the value of gold will be diminished — in both countries. We see then that the value of gold may possibly go down without any influx of the metal to the gold countries and even without any increase of paper money in other countries — supposing, of course, its being depreciated before — solely as the effect of large borrowing going on from the side of the paper countries.

Now in a case such as that of America and England — disregarding for simplicity's sake, as does Professor Taussig himself, customs duties and the like — only one new factor enters, namely the cost of carrying, a point curiously enough

not at all touched by Professor Taussig. If the costs of carrying are unaltered by the borrowing operations, I cannot see why this case should not be as simple as the one treated above. But they will not be unaltered, and in this circumstance, or I am much mistaken, the real source of explanation of the phenomena, actually observed or to be expected, must be sought.

First of all, in two countries separated by the ocean there will hardly be the same price for any commodity. The goods imported to America from England must needs be so much higher in price in the former country as is sufficient to cover the charges for freight and insurance. Similarly the goods exported from America will be cheaper in America than in England by the amount of their freight and insurance charges. If we grant, as for the sake of argument we may do, that these charges to begin with are of equal amount, then the average level of prices in both countries will be about the same at first, but not after the borrowing has set in (from the side of America) because of the altered proportions of imports and exports which will follow.

The increased number of ships going from England to America with full load, and bound to go back in ballast or with insufficient cargo, must needs increase the transport charges on goods going one way and diminish the cost of sending goods the other way. What part of this burden will fall on either country seems to be a rather secondary question; the simplest supposition, which we shall here make, is that it will be divided equally between both countries. At any rate the difference of prices in the two countries shown by the goods carried from England to America will be greater than before, whereas the goods going the opposite way will show a smaller difference of prices than before. Both the imported and the exported commodities, therefore, will have a tendency to rise in America and to fall in England; which will be greater, the rise or the fall, is not easy to discern. Consequently the general level of prices will have been raised in America and lowered in England; and therefore, if both countries were living on a specie régime, a certain amount of

gold — greater than in the former case — would flow from England to America at the beginning of the borrowing period. But this influx would be the effect, not the cause of the rise of American prices, and if convertible bank notes in greater amount than before were issued in America, that influx might be superseded altogether, the range of prices still going upwards in the same way.

If, on the contrary, America had inconvertible paper money, the result would differ just as in the two cases treated above. Prices in England would slightly rise. American prices, *calculated in gold,* would rise even more than under a specie régime. Calculated in paper, however, they would slightly fall, so that perhaps the specie premium might for the time being totally disappear, if only to show itself again when the borrowing ceases. But in other respects things would go on, it seems to me, pretty much in the same way as under a specie régime. For the further differences between the two cases, pointed to by Professor Taussig, I hardly think sufficient reasons are shown; they may present themselves, of course, under special conditions, but not as the general rule.

Before laying down my pen I would draw the attention to a most important consequence of the reflections above, supposing them to be true, in respect of the present monetary relations between America and England, which of course have just the opposite turn. According to index numbers the level of prices in England has risen during the war incomparably more than in America, but still the rate of exchange between them has not diverged much from par. Some economists, for instance in Sweden, have seen in these conditions an abnormal, " artificial " state of things, only to be explained by the heavy borrowing constantly going on between the two countries, by which, it is said, the parity of exchange is maintained in spite of the difference of prices. The true explanation, however, will be seen to go just the opposite way. The difference of prices itself, not the parity of exchange, is the effect of the borrowing and this precisely because of its influence upon the height of freights. Freights of course have risen enormously both ways, but altho I have only a few

figures at hand, it seems to me unthinkable that they should have risen by nearly so much in the trade between England and America as in that between America and England.[1] This then accounts for the different levels of prices or rather for the difference between the two levels. The parity of exchange, on the other hand, requires no explanation so long as England maintains tolerably well the convertibility of its notes into gold. In two countries separated only by a land boundary, this could not occur, as we have shown; there a difference of prices *always* would mean a depreciation of one of the monetary standards and a corresponding deviation of the rates of exchange from par.

However, in the actual case still another circumstance is operating. Theoretically, i. e., other things being equal, the average level of prices in America would have gone down — just as the prices of England in the third of our cases above. The prices of imported commodities, it is true, in the present case would not have gone down, in view of the general enhancement of freights during the war, but the export prices in America would have forcibly fallen, because of the great enhancement of export freights. This, however, has not taken place, and the explanation lies at hand; it depends on the general depreciation of gold all over the world, caused, no doubt, in the main by the unexampled paper issues of almost all countries, or, I should rather say, by the most irrational discount policy of the leading banks, the rates of which, in my opinion, ought to have been much higher during the whole war. Consequently the average depreciation of gold is not to be estimated by the actual rise of prices in America. That

[1] According to the Swedish "Commercial Informations" freight rates from La Plata to Great Britain have risen during the war nearly three times as much as those from Great Britain to La Plata. Similarly freight rates from Egypt to Great Britain have risen more than twice as much as those from Great Britain to Egypt. For other countries figures are only given for freights to England, but very probably the same state of things has appeared for them. There are occasional exceptions: thus, coal freights from Great Britain have risen slightly more than the wood freights to Great Britian from Sweden.—

The general situation is the same for freight rates between the United States and England as that which Professor Wicksell here notes for rates between Sweden and England. East bound rates across the Atlantic (to England) have risen much more than west bound rates (from England). — F. W. T.

would give too small a measure; to it must be added the hypothetical fall of average prices in America, which would have come to pass, if there had been no general cause for the depreciation of gold.

I should be very glad if these lines, of whose extremely abstract character I am well aware, could be regarded as a suitable complement to the interesting remarks on the subject made by Professor Taussig.

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PROFESSOR WICKSELL'S mode of dealing with the subject is in many respects different from that to which I have been accustomed. It is, therefore, not always easy for me to follow his reasoning. I will touch only on some salient points.

The whole problem of the relation between prices and the movement of money (gold) is handled by Professor Wicksell in terms which lead me to pause. He agrees that where international borrowing takes place, a larger volume of commodities will be bought and sold in the borrowing country than before. But in his opinion, the stimulus which brings about this quantitative increase is not to be found in a difference of prices between the two countries. He believes (page 405) that " the increased demand for commodities in one country, the diminished demand in the other, will in the main be sufficient to call forth the changes alluded to." And he remarks that " the larger circulation of merchandise in the borrowing country would *require*, other things being equal, a somewhat greater amount of money to put them in motion; very likely, therefore, a certain quantity of gold would pass *automatically* from the lending to the borrowing country." [1] This seems to me questionable. I find it difficult to conceive how " increased demand for commodities " will cause a rise in the price of commodities, unless more money is offered for

[1] Italics are mine.

them; and no more money can be offered for them unless the supply of money is larger. (It is not necessary to state the modifications which must be attached to any such bald statement of the " quantity theory "; the conversant reader will bear them in mind.) Professor Wicksell's statement that a larger circulation of goods requires a greater amount of money " to put them in motion," seems to me metaphorical and inconclusive. If there be more goods and no more gold, and if this is the sole change that takes place, prices will fall. That fall in prices may lead in turn to a redistribution of gold and to an eventual increase in the monetary supply in the country where prices at first were lower. But the process is one that requires time; there is a period of transition before the eventual result is reached. The gold moves, not "automatically," but as a *result* of changed prices, or (for short periods) of changed rates of discount.

A similar difference in point of view appears in another passage in Professor Wicksell's note (page 408) where, discussing variations in price movements as between the United States and England, he remarks that the " difference of prices itself is the effect of borrowing." It does not seem to me to be in itself a consequence of borrowing, or of an automatic adjustment of monetary supply to quantity of commodities bought and sold. The change in prices, to repeat, seems to me an ulterior consequence, not a direct or automatic one.

I find a further difficulty. Professor Wicksell seems throughout to treat the movements of prices for domestic commodities and for international commodities as if they were always parallel, and as if the influences acting on the one set always acted in the same way on the other.[1]

At the very outset, he passes from a statement about the prices of competitive or international commodities to another statement, by no means a corollary, about the general level of prices. It is true that, if we ignore cost of transportation, the same commodity must be at the same

[1] On the importance of this distinction I have said something in an article on " Wages and Prices in International Trade," in this Journal, August, 1906.

price in contiguous countries; but it by no means follows that the general level of prices must be the same in both, still less the general level of money incomes. And this distinction is important as regards the influence of freight rates, to which he attaches such importance. He argues, for example, that a readjustment of freight rates, consequent on international borrowing, would have different effects in the borrowing country from those in the lending country. He reasons that transportation rates would be higher than before on commodities going to the borrowing country, because of the greater freight space required; whereas ships going the other way would be half empty or in ballast, and consequently would accept lower freight rates. I will not stop to discuss how far such changes in ocean freight rates are likely to take place under ordinary conditions of foreign trade. In times of peace, with an abundance of tramp steamers and triangular or roundabout voyages, effects of this kind would probably be inconsiderable. Under the present abnormal shipping conditions, Professor Wicksell's hypothesis is in accord with the facts: while all ocean freights have risen greatly, inbound rates to Western Europe have risen very much *more* than outbound rates. But admitting this to be now the case, and even supposing a similar situation to arise when international loans are made in times of peace, this particular shift does not seem to me to have the sort of significance for the theory of international trade which Professor Wicksell attributes to it. Changes in transportation charges would affect directly not the general level of prices, but the prices of international commodities only. Imported commodities would indeed be higher in the borrowing country if sent thither from the lending country. But it does not at all follow that this factor in itself would cause a general rise of prices in the borrowing country. It is entirely possible that the prices of iron, for instance, should rise in the United States when imported from England, say as a sequel to American loans there, because cost of transportation from England to the United States may have risen. But at the same time domestic prices and money incomes in the United States may have remained stationary.

If they have risen, it will be because of increased monetary supply; and the rise will be due to a different cause from the increase of freight rates, and may be greater or less in extent.

The same problem suggests itself in connection with Professor Wicksell's discussion of countries separated by a land frontier and those separated by the ocean. In the former case he thinks cost of transportation is negligible; for the latter he treats it as a matter of some consequence. Here again it may be a question whether the particular distinction is in fact of importance. Transportation by water is so much cheaper than by land that the effective range of possible price variation for a given article may be less between England and the eastern seaboard of the United States than between Germany and Austria. But this query does not touch the point which I find troublesome in Professor Wicksell's general reasoning. He seems to assume that between two countries separated by land frontier (in which case, on his assumption, we may neglect expenses of transportation), prices will be identically the same throughout the two for all commodities. By no means. Between such countries the prices of international commodities will doubtless be the same; but the prices of domestic commodities and, above all, the rates of money incomes may be substantially different. It is precisely these differences in domestic prices and in money incomes which constitute the special and peculiar problems of the theory of international trade.

Hence, to conclude, the effects of changes in freight rates, which Professor Wicksell regards as a neglected unimportant factor in the theory of international trade and international borrowing, do not in my judgment lead to new generalizations. Their effects are similar to those of changes in cost of production or cost of transportation within a country. These may cause lower prices of particular commodities within the country, or in foreign countries; but the consequences for the different price levels in different countries depend on quite other factors than those adduced by Professor Wicksell, and more particularly on the elasticity of demand for the commodities in question.

I would not close this note without expressing my appreciation of the high interest of Professor Wicksell's comments, and of the value of discussion from a novel point of view; nor without expressing my satisfaction that he proceeds on the principle that, however the course of international trade be disturbed by the shock of war, the international exchange of scientific opinion should be maintained without interruption.

F. W. TAUSSIG.